

## KENAI PENINSULA BOROUGH SCHOOL DISTRICT

### Assistant Superintendent

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March 15, 2011

TO: Board of Education

FROM: Dave Jones, Assistant Superintendent

SUBJECT: Proposed Policy Revision BP 3470

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The following policy was reviewed by the Board Policy Committee on March 7, 2011 and is scheduled to be reviewed at a Board Worksession on April 4, 2011. This is also scheduled for first reading at the Board Meeting on April 4, 2011.

The administration recommends making the following changes to policy:

*BP 3470 Fund Balance* – Revised to incorporate the changes to GASB 54 regulations into our policy. GASB 54 requires the following categories of Fund Balance: nonspendable fund balance, restricted fund balance, committed fund balance, assigned fund balance and unassigned fund balance. Changes are required by June 30, 2011 to remain compliant with Generally Accepted Accounting Procedures (GAAP). The old Reserved, Unreserved, Designated and Undesignated categories will no longer be accepted in reference to fund balance.

Attachments:

*GASB Fact Sheet about Fund Balance Reporting and Governmental Fund Type Definitions*

*Balancing Governmental Budgets Under GASB 54*

**FUND BALANCE**

**Purpose of Fund Balance**

An appropriate fund balance is a critical factor in the long range financial planning of a school district to assure sound financial practices and management. There is a need to maintain a cash flow to provide financial reserves for unanticipated expenditures and/or revenue shortfalls of an emergency nature. Examples of these situations follow:

- Unexpected costs incurred by mandated, but not funded, State or Federal programs,
- Increased utility costs due to abnormal price increase or unusually cold weather,
- Greater than expected inflation,
- Unexpected decrease in Federal, State or Local revenue,
- Unexpected deficits in other operating funds (Student Nutrition Services, Transportation),
- Unexpected decrease in student enrollment.

**Definitions**

**Fund Balance** - the cumulative difference between revenues and expenditures; it approximates available resources absent significant liabilities.

**Fund Balance Classifications** - GASB 54 established five classifications for fund balance as follows:

- *Nonspendable fund balance*—amounts that are not in a spendable form (such as inventory) or are required to be maintained intact (such as the corpus of an endowment fund)
- *Restricted fund balance*—amounts constrained to specific purposes by their providers (such as grantors, bondholders, and higher levels of government), through constitutional provisions, or by enabling legislation

**FUND BALANCE (continued)**

• Committed fund balance—amounts constrained to specific purposes by a government itself, using its highest level of decision-making authority; to be reported as committed, amounts cannot be used for any other purpose unless the government takes the same highest-level action to remove or change the constraint

• Assigned fund balance—amounts a government intends to use for a specific purpose; intent can be expressed by the governing body or by an official or body to which the governing body delegates the authority

• Unassigned fund balance—amounts that are available for any purpose; these amounts are reported only in the general fund.

The five categories of fund balance place varying strengths of spending constraints on available resources in a descending order as listed. Nonspendable fund balance is the most restrictive classification and unassigned fund balance is the least restrictive.

**Reserved Fund Balance**State of Alaska Reserve Allowances —portion of Fund Balance that is legally restricted to a specific use or otherwise not available for appropriation or expenditure. Alaska Administrative Code 4 AAC 09.160 (not GAAP compliant) establishes that reserves in the year-end fund balance in a school's operating fund may be only in the following categories:

- (1) Encumbrances,
- (2) Inventory,
- (3) Prepaid expenses including fuel,
- (4) Retirement incentive program,
- (5) Self-insurance and
- (6) Federal impact aid received in response to the application submitted during fiscal year of the audit under 4 AAC 09.130.

**Unreserved Fund Balance**—portion of remaining Fund Balance that is available for appropriation or expenditure. This is further separated into (1) designated and (2) undesignated fund balances.

**FUND BALANCE (continued)**

- ~~1. **Designated Fund Balance**—portion of the Unreserved Fund Balance which reflects tentative management plans for future use of the resources for purposes described in the financial statements.~~
- ~~2. **Undesignated Fund Balance**—portion of the Unreserved Fund Balance which is not obligated or specifically designated and is available to be appropriated for future purposes.~~

**Policy**

Alaska Statute AS 14.17.505 establishes that a District may not accumulate in a fiscal year an unreserved portion (as defined by 4 AAC 09.130) of its year-end fund balance in its school operating fund, ~~as defined by department regulations~~ that is greater than 10 percent of its expenditure for that fiscal year.

It is the policy of the District to maintain a General Fund ~~Unreserved Undesignated~~Unassigned Fund Balance which does not exceed 5 percent of the prior year's General Fund expenditures. Any amount in excess of this 5 percent will be utilized to reduce the School District request for local effort funding for the subsequent year.

When an expenditure has been duly authorized and funding to pay for the expenditure is available within multiple fund balance classifications, the funding available in the most restrictive classification will be used first.

*Legal References:*

ALASKA ADMINISTRATIVE CODE  
4 AAC 09.130 School District Audit  
4 AAC 09.160 Fund Balance

ALASKA STATUTES  
AS 14.17.505 Fund Balance in School Operating Fund

**KENAI PENINSULA BOROUGH SCHOOL DISTRICT**  
**Adoption Date: April 5, 2010**



## Fact Sheet about Fund Balance Reporting and Governmental Fund Type Definitions

### 1. Why has the GASB issued new standards for reporting fund balance?

The GASB issued Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, to address issues related to how fund balance was being reported. The GASB's original intention was to clear up confusion regarding the relationship between reserved fund balance and restricted net assets. However, the GASB's research revealed that the existing standards guiding fund balance reporting were being interpreted inconsistently by different governments. Consequently, the fund balance information reported by many governments also was inconsistent. It also became clear that the understandability of fund balance information was affected and that financial statement users were unable to readily interpret reported fund balance information.

### 2. Why did the GASB decide not to just clarify the existing fund balance classifications (reserved, designated, unreserved)?

The GASB considered pursuing a solely educational approach to these issues. However, it became apparent based on interviews and survey results that, even if all governments interpreted the requirements consistently, the resulting information would not meet the needs of people who use fund balance information to identify available resources and assess liquidity and financial flexibility.

### 3. How will governments report fund balance in the future?

Fund balance will be displayed in the following classifications depicting the relative strength of the spending constraints placed on the purposes for which resources can be used:

- *Nonspendable fund balance*—amounts that are not in a spendable form (such as inventory) or are required to be maintained intact (such as the corpus of an endowment fund)
- *Restricted fund balance*—amounts constrained to specific purposes by their providers (such as grantors, bondholders, and higher levels of government), through constitutional provisions, or by enabling legislation
- *Committed fund balance*—amounts constrained to specific purposes by a government itself, using its highest level of decision-making authority; to be reported as committed, amounts cannot be used for any other purpose unless the government takes the same highest-level action to remove or change the constraint
- *Assigned fund balance*—amounts a government *intends* to use for a specific purpose; intent can be expressed by the governing body or by an official or body to which the governing body delegates the authority

- *Unassigned fund balance*—amounts that are available for any purpose; these amounts are reported only in the general fund.

#### **4. Why is unassigned fund balance reported only in the general fund?**

When a government transfers resources from the general fund to another governmental fund, it is communicating that, at a minimum, it intends to use those resources for the purpose of the fund receiving them. This expression of intent meets the requirements for classification as assigned fund balance. Because unassigned fund balance represents amounts that are not constrained in any way, not even by an intention to use them for a specific purpose, the general fund is the only appropriate place to report this classification of fund balance.

In the other governmental funds, however, if a government spends more on a specific purpose than the resources available for that purpose in the fund, then it may need to report a negative amount as unassigned fund balance. If a government cannot cover the deficit with amounts assigned to other purposes in that fund, then the remaining deficit should be reported on the unassigned fund balance line.

#### **5. How will rainy-day amounts be reported under Statement 54?**

Statement 54 treats stabilization arrangements as a specific purpose, allowing governments to report these amounts in the general fund as restricted or committed, if they meet the applicable definitions and criteria. Stabilization amounts that do not qualify to be reported as restricted or committed should be included in unassigned fund balance. Governments may report stabilization amounts in a special revenue fund only if they derive from specific revenue sources that are restricted or committed to stabilization.

Regardless of where stabilization amounts are reported, governments also will disclose key information about their stabilization arrangements in the notes to the financial statements, including the authority by which the arrangements were established, the conditions under which additions to the stabilization amounts are required, and the circumstances under which amounts may be used.

#### **6. How has Statement 54 changed the way encumbrances are reported?**

The new standards clarify that an encumbrance is not a specific purpose and therefore should not be reported as a separate line on the face of the balance sheet. Encumbering amounts that are restricted or committed does not further limit the purposes for which they can be used. If the encumbering process meets the definition and criteria for committed fund balance, then encumbering an assigned or unassigned amount could result in the amount being reported as committed; however, it would be reported with other amounts committed to the same or similar purposes, *not* as “committed for encumbrances.” If a government has significant encumbrances, it should disclose them under the standards for significant commitments.

**7. What did the GASB find out about the reporting of governmental funds?**

In practice, many governments have interpreted in different ways the prior standards on reporting governmental funds contained in National Council on Governmental Accounting (NCGA) Statement 1, *Governmental Accounting and Financial Reporting Principles*. This is particularly true for special revenue funds.

**8. How does Statement 54 clarify the special revenue fund type definition?**

Statement 54 makes clear that, for financial reporting purposes, a special revenue fund may only be established around one or more revenue sources that are restricted or committed to purposes other than capital projects or debt service. For example, a school district might report state and federal aid for elementary and secondary education in a special fund if those revenue sources represent a substantial portion of the fund's total inflows.

**9. How does Statement 54 clarify the definitions of debt service and capital projects fund types?**

Statement 54 revises the definitions of the debt service and capital projects fund types so that consistent language and structure are used across all of the governmental fund type definitions. Although the existing definition of a capital project fund specifies that they should be used to account for "the acquisition or construction of major capital facilities," many governments have used them to report on capital assets that are not facilities or major or either. Based on constituent feedback, the GASB broadened the definition to encompass capital outlays in general.

**10. How will Statement 54 impact the reporting of governmental funds?**

The most significant changes are likely to occur in the reporting of special revenue funds, because that is where there has been the most variation in how the prior standards were interpreted. Some governments may not be able to continue to report some of their special revenue funds under the clarified definition. The Statement 54 definition is considered by some to be more permissive than the NCGA Statement 1 definition. However, practice has varied so much that the Statement 54 definition may appear more restrictive to some governments.

**11. Does Statement 54 affect how governments use funds for internal accounting purposes or for special reporting?**

No. Statement 54 affects only the *reporting* of governmental funds in general purpose external financial reports in conformity with generally accepted accounting principles (GAAP). Governments may continue to use any funds they choose or are required to for their internal accounting or for special purpose reporting.

**12. What if a state law requires local governments to report a particular type of fund or to report using the current classifications of fund balance?**

For general purpose external financial reporting under GAAP, governments are required to follow Statement 54. If a law conflicts with Statement 54 or any other part of GAAP, the legal requirements can be met by presenting supplemental schedules. Governments will still be able to comply with such state laws in their general purpose external financial report, but outside of the basic financial statements, notes to the basic financial statements, and required supplementary information.

**13. What other note disclosures does Statement 54 require?**

In addition to the disclosures already mentioned, Statement 54 requires governments to disclose:

- Additional detail regarding the purposes of restrictions, commitments, and assignments, if the required level of detail is not met through display on the face of the balance sheet
- The decision-making authority and formal action, if any, that results in commitments of fund balance
- The bodies or persons with the authority to express intended uses of resources that result in assigned fund balance
- The order in which a government assumes restricted, committed, assigned, and unassigned amounts are spent when amounts in more than one classification are available for a particular purpose
- Information about minimum fund balance policies, if a government has one
- The purpose for each major special revenue fund, identifying which revenues and other resources are reported in each of those funds.

**14. When should Statement 54 be implemented?**

Governments should implement Statement 54 no later than the first fiscal year beginning after June 15, 2010 (for example, the fiscal year starting on July 1, 2010 and ending on June 30, 2011). Governments are encouraged to implement the standards earlier.



# Balancing Governmental Budgets Under GASB 54

by Bruce W. Chase, CPA, Ph.D.,  
and John B. Montoro, CPA

**F**und balance is an important measure that represents the difference between a fund's assets and liabilities. The overall objective of fund balance reporting is to isolate that portion of fund balance that is unavailable to support the following period's budget.

Because governmental funds' measurement focus is the flow of financial resources, the balance sheet primarily reports assets and liabilities that represent net spendable and available resources for these funds. In many ways, fund balance represents working capital, which can either be used as a liquidity reserve or for spending in future years.

Many state and local governments are experiencing revenue shortfalls and are facing difficult decisions in balancing their budgets. One option some governments have is to use a portion of fund balance to offset revenue declines and balance the current-year budget. However, not all amounts reported as part of fund balance are available to be used in a future budget.

Under current practice, fund balances are either classified as reserved or unreserved. Many governments also designate part of unreserved fund balance. Recent research conducted by GASB shows a lack of consistency among governments in reporting the components of fund balance and that the components are often misunderstood by financial statement users. It is often unclear if any of the reserved or designated fund balances are available to help balance a government's budget.

GASB Statement no. 54, *Fund Balance Reporting and Governmental Fund Type Def-*

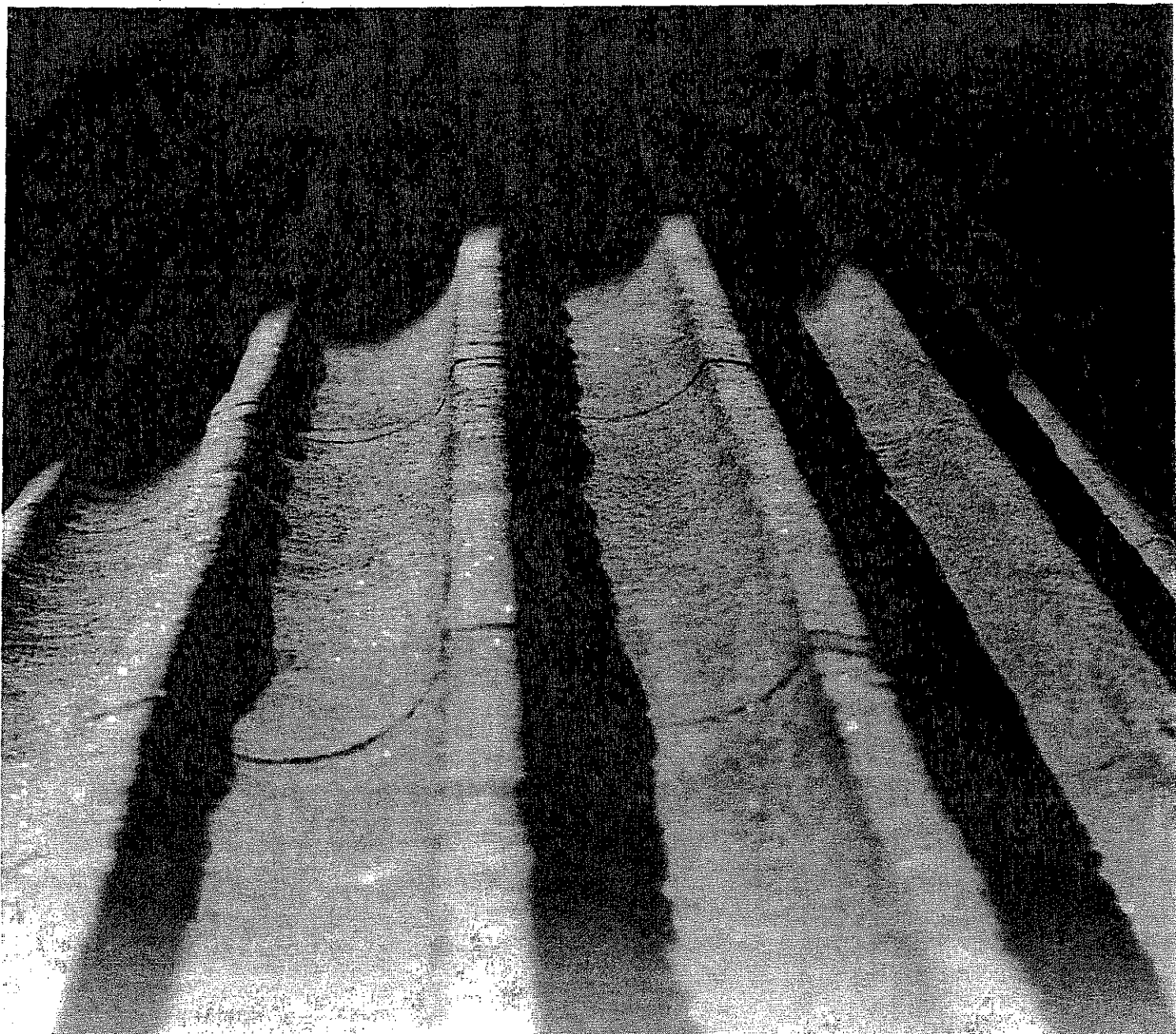
*initions*, will significantly change how this information is reported. The statement is intended to improve the usefulness of the amount reported in fund balance by providing more structured classification. The statement also clarifies the definition of existing governmental fund types.

The purpose of this article is to assist governments and auditors in preparing for the reporting requirements of Statement no. 54 and to discuss possible policy changes governments should consider as they approach adoption of this statement, which is effective for periods beginning after June 15, 2010 (GASB encourages early implementation). In addition, it will help citizens and decision makers better understand the constraints placed on fund balances.

## GASB'S SOLUTION

To improve the reporting of fund balance, a hierarchy of fund balance classifications has been created based primarily on the extent to which governments are bound by constraints on resources reported in the funds. This approach is intended to provide users more consistent and understandable information about a fund's net resources.

The hierarchy of five possible classifications of fund balance is:



#### **Nonspendable Fund Balance**

- Amounts that cannot be spent due to form; for example, inventories and pre-paid amounts. Also, long-term loan and notes receivables, and property held for resale would be reported here unless the proceeds are restricted, committed or assigned.
- Amounts that must be maintained intact legally or contractually (corpus or principal of a permanent fund)

#### **Restricted Fund Balance**

- Amounts constrained for a specific purpose by external parties, constitutional provision or enabling legislation. This is the same definition used by GASB Statement no. 34, *Basic Financial*

*Statements—and Management's Discussion and Analysis—for State and Local Governments*, for restricted net assets.

#### **Committed Fund Balance**

- Amounts constrained for a specific purpose by a government using its highest level of decision-making authority. It would require action by the same group to remove or change the constraints placed on the resources.
- Action to constrain resources must occur prior to year-end; however, the amount can be determined in the subsequent period.

#### **Assigned Fund Balance**

- For all governmental funds other than

the general fund, any remaining positive amounts not classified as nonspendable, restricted or committed.

- For the general fund, amounts constrained for the intent to be used for a specific purpose by a governing board or a body or official that has been delegated authority to assign amounts. Amount reported as assigned should not result in a deficit in unassigned fund balance.

#### **Unassigned Fund Balance**

- For the general fund, amounts not classified as nonspendable, restricted, committed or assigned. The general fund is the only fund that would report a positive amount in unassigned fund balance.
- For all governmental funds other than

## Exhibit 1 Special Revenue Fund Order of Spending Policy

Impact of Fund Balance Classification				
Case A				
Order of Use: Restricted, Committed, Assigned				
	Total	Restricted	Committed	Assigned
Beginning Balance	\$10,000	\$4,000	\$4,000	\$2,000
Expenditures	7,000	4,000	3,000	0
Ending Balance	\$ 3,000	\$ 0	\$1,000	\$2,000
<i>Ending fund balance reported as committed or assigned</i>				
Case B				
Order of Use: Unrestricted, Assigned, Committed				
	Total	Restricted	Committed	Assigned
Beginning Balance	\$10,000	\$4,000	\$4,000	\$2,000
Expenditures	7,000	1,000	4,000	2,000
Ending Balance	\$ 3,000	\$3,000	\$ 0	\$ 0
<i>Ending fund balance reported as restricted</i>				

the general fund, amount expended in excess of resources that are nonspendable, restricted, committed or assigned (a residual deficit). In determining a residual deficit, no amount should be reported as assigned.

Not all governments will have all five components of fund balance. Governments should review their current policies and procedures to determine if resources would meet the definition of committed or as-

signed. Additional policies may need to be adopted or revised to be consistent with the new definitions.

A number of policies discussed in this article may need to be adopted or revised under Statement no. 54. In addition, several new note disclosures are required (see sidebar, "Note Disclosures").

### COMPUTING THE BALANCES

This may not be as easy as it seems. Total

fund balance must be classified into one of the five possible categories described above at the end of each year. A government policy on the order in which resources are to be expended is an important factor in how amounts are reported in fund balance. Under Statement no. 34, governments were required to have a policy regarding whether it considers the use of restricted or unrestricted resources first when both are available for expenditure. This policy

### EXECUTIVE SUMMARY

■ GASB Statement no. 54 establishes a hierarchy of fund balance classifications based primarily on the extent to which governments are bound by constraints placed on resources. Governments need to consider several things before implementing this reporting standard.

■ Statement no. 54 clarifies the definition of existing governmental fund types. Because of the timing of the budget cycle,

governments need to assess early the impact of this statement on reporting information for governmental funds.

■ Governments must determine if current special revenue funds meet the revised fund definition for such funds. They should establish a policy on the order in which unrestricted resources are to be used when any of these amounts are available for expenditure. Finally, governments

should review their current policies and procedures to determine if resources would meet the definition of committed or assigned.

■ Statement no. 54 is effective for financial statements for periods beginning after June 15, 2010. GASB encourages early implementation.

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**Exhibit 2** Display of Constraints on Fund Balance

	General Fund	Major Special Revenue Funds		Major Debt Service Fund	Major Capital Projects Fund	Other Funds	Total
		Highway Fund	School Aid Fund				
<b>Fund Balances:</b>							
<b>Nonspendable:</b>							
Inventory	\$ 125,000	\$ 108,000	\$ 16,000	—	—	—	\$ 249,000
Permanent fund principal	—	—	—	—	—	\$ 164,000	164,000
<b>Restricted for:</b>							
Social Services	240,000	—	—	—	—	—	240,000
Parks and Recreation	30,000	—	—	—	—	—	30,000
Education	55,000	—	—	—	—	—	55,000
Highways	—	—	—	—	\$ 444,000	—	444,000
Road surface repairs	—	24,000	—	—	—	—	24,000
Debt service reserve	—	—	—	\$ 206,000	—	—	206,000
School construction	—	—	—	—	301,000	—	301,000
Law enforcement	—	—	—	—	—	214,000	214,000
Other capital projects	—	—	—	—	51,000	—	51,000
Other purposes	30,000	—	—	—	—	—	30,000
<b>Committed to:</b>							
Zoning board	16,000	—	—	—	—	—	16,000
Economic stabilization	210,000	—	—	—	—	—	210,000
Homeland security	110,000	—	—	—	—	—	110,000
Education	50,000	—	103,000	—	—	—	153,000
Health and welfare	75,000	—	—	—	—	—	75,000
<b>Assigned to:</b>							
Parks and Recreation	50,000	—	—	—	—	—	50,000
Library acquisitions	50,000	—	—	—	—	—	50,000
Highway resurfacing	—	258,000	—	—	—	—	258,000
Debt service	—	—	—	306,000	—	—	306,000
Public pool	—	—	—	—	121,000	—	121,000
City Hall renovation	—	—	—	—	60,000	—	60,000
Other capital projects	50,000	—	—	—	471,000	—	521,000
Other purposes	80,000	—	73,000	—	—	176,000	329,000
<b>Unassigned:</b>	525,000	—	—	—	—	—	525,000
<b>Total fund balances</b>	<b>\$1,746,000</b>	<b>\$ 390,000</b>	<b>\$ 192,000</b>	<b>\$ 512,000</b>	<b>\$1,448,000</b>	<b>\$ 554,000</b>	<b>\$4,842,000</b>

This level of detail is not required for display on the face of the balance sheet. Fund balance categories and classifications may be presented in detail or in the aggregate if sufficient detail is provided in the notes to the financial statements.

	General Fund	Major Special Revenue Funds		Major Debt Service Fund	Major Capital Projects Fund	Other Funds	Total
		Highway Fund	School Aid Fund				
<b>Fund balances:</b>							
<b>Nonspendable</b>	\$ 125,000	\$ 108,000	\$ 16,000	—	—	\$ 164,000	\$ 413,000
<b>Restricted</b>	405,000	24,000	—	\$ 206,000	\$ 796,000	214,000	1,645,000
<b>Committed</b>	461,000	—	103,000	—	—	—	564,000
<b>Assigned</b>	230,000	258,000	73,000	306,000	652,000	176,000	1,695,000
<b>Unassigned</b>	525,000	—	—	—	—	—	525,000
<b>Total fund balances</b>	<b>\$1,746,000</b>	<b>\$ 390,000</b>	<b>\$ 192,000</b>	<b>\$ 512,000</b>	<b>\$1,448,000</b>	<b>\$ 554,000</b>	<b>\$4,842,000</b>

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now applies at the fund level for restricted and unrestricted (committed, assigned or unassigned) resources.

Likewise a government should establish a policy on the order in which unrestricted resources are to be used when any of these amounts are available for expenditure. If a government does not establish a policy, the default approach assumes that committed amounts should be reduced first, followed by the assigned amounts, and then the unassigned amounts.

Governments must consider the impact on the components of fund balance when determining their policy on which funds are used first. Exhibit 1 reflects the results of two policies related to unrestricted resources. In Case A, the government elected a policy to use restricted amounts before unrestricted amounts. A policy was not elected on the use of unrestricted amounts; therefore, the default will be used where committed resources are used first. Under this approach, all of the ending fund balance is unrestricted and reported as either committed or assigned.

In Case B, the government elected a policy to use unrestricted amounts before restricted amounts. They also elected a policy to use assigned amounts before committed amounts. Under this approach, all of the ending fund balance is reported as restricted. The accounting policy choice on which resources are used first can significantly affect how balances are reported.

For most governments, determining the components of fund balance will be an annual exercise. The first step is to determine the amount that should be reported as nonspendable. For all but the general fund, the remaining amounts must be allocated to restricted, committed or assigned by reviewing the constraints placed on available resources and by applying the order of spending policy just discussed. Assigned fund balance is the residual classification after amounts have been classified as nonspendable, restricted or committed. However, if there is a negative balance after classifying

### Note Disclosures

Governments will be required to disclose more information about amounts reported in fund balance:

- Description of authority and actions that lead to committed and assigned fund balance.
- The government's policy regarding order of spending regarding restricted and unrestricted fund balance and the order of spending for committed, assigned and unassigned.
- For any stabilization arrangements, the authority for establishing, requirements for additions, and the conditions under which amounts may be used. If not reported on the face of the financial statements, the stabilization balance.
- Description of any formally adopted minimum fund balance policies.
- The purpose of each major special revenue fund and which revenues or other sources are reported in each of those funds.
- Encumbrances, if significant, are reported in conjunction with other disclosures of significant commitments.

amounts as nonspendable, restricted or committed, the fund would report a negative amount as unassigned. In this case no amount would be reported as assigned.

For the general fund, unassigned fund balance is the residual classification after amounts have been classified as nonspendable, restricted, committed or assigned. Only the general fund would report a positive amount as unassigned. A negative residual amount would be eliminated by reducing unassigned balance based on the government's order of spending policy. No funds should report a negative amount for restricted, committed or assigned fund balance.

### ENCUMBRANCES

For governments that use encumbrance accounting, encumbering funds that are already restricted, committed or assigned based on the source and strength of the constraints placed on them does not further limit the use of the amounts reported in these classifications. A government should not report amounts that are encumbered.

However, amounts encumbered for a specific purpose for which amounts have not been previously restricted, committed or assigned, should be classified as either committed or assigned, based on the criteria previously discussed for these two classifications. Significant encumbrances at year-end should be disclosed in the notes to the financial statements, along with other significant commitments.

### STABILIZATION FUNDS

Some governments have stabilization funds to cover such things as revenue shortfalls, emergencies or other purposes. The authority to set aside resources often comes from a statute, ordinance or constitution. The formal action that creates these funds should identify and describe the specific circumstances under which these funds may be used. These circumstances should not be expected to occur regularly. Stabilization funds can be classified as either restricted or committed fund balance if they meet the criteria previously discussed. If the criteria of restricted or committed are not met, then stabilization agreements should be reported as unassigned.

### REPORTING THE BALANCES

Governments can choose where to disclose information about constraints placed on the different classifications of fund balance. The information can be displayed on the face of the balance sheet, or only aggregate amounts can be reported with the constraints disclosed in the notes to financial statements.

For nonspendable fund balance, the amount not in spendable form and the amount that must be maintained intact must be disclosed separately. For restricted fund balance, major restricted purposes

## Audit Impact

An auditor must consider several things in preparing for an audit client under GASB Statement no. 54. He or she must review the client's policies for the authority and actions that lead to committed and assigned fund balances, the order of spending, and the creation of governmental funds. The auditor needs to obtain assurance that the policies are properly documented, being followed, and are properly disclosed in the notes to financial statements.

The auditor will also need to conduct a review of current governmental funds, particularly special revenue funds. This review should include major and nonmajor funds.

In one test case, nearly one-third of a government's special revenue funds did not appear to meet the revised special revenue fund definition (10 funds out of 31). For example, funds with residual balances, those that do not have a significant committed revenue source, and funds that receive most or all of their revenue as a transfer from another fund would likely not meet the revised definition for a special revenue fund. Special revenue funds that do not meet the revised fund definition should be reported as part of the general fund. For this government, reporting the funds as part of the general fund would have a material impact on the fund balance.

It is likely that the fund balance classification will be performed as a part of year-end financial reporting and recorded in a subsidiary ledger (spreadsheet). Controls should be established over this aspect of financial reporting and need to be documented and tested in accordance with current risk-based auditing standards.

should be disclosed. Major specific purposes should also be disclosed on committed and assigned fund balance.

Exhibit 2 is from Appendix C of Statement no. 54. It provides an example of displaying the information about constraints on fund balance on the face of the financial statements and an example of only showing aggregate amounts for fund balance.

## FUND DEFINITION

As part of the fund balance project, GASB determined that clarifying certain terms used in fund type definitions would improve consistency on how fund types are reported. This was a limited-scope approach to fund type definitions and is not intended to impose more restrictive interpretations on the use of the various fund types than the current standard. However, research shows that many governments are not following current standards, especially as they relate to special revenue funds.

The changes to the general fund, debt service fund and capital project fund definitions are minor and, in most cases, just reflect the new terms of restricted, committed and assigned included in this standard.

The changes to the special revenue fund definition included additional guidance on when resources should be reported in this fund. The definition of a special revenue fund is: "Special revenue funds are used to account and report the proceeds of specific revenue sources that are restricted or committed to expenditure for specific purposes other than debt service or capital projects."

The standard says that the foundation for the fund should be from a revenue source that is either restricted or committed. That restricted or committed revenue source should be expected to continue to represent a substantial portion of the inflows reported in that fund. Other restricted, committed or assigned revenue may be reported in that fund. At any point the government does not expect that a substantial portion of the inflows will be from restricted or committed resources, the government should stop using a special revenue fund and report the remaining resources in the general fund.

This definition of a special revenue fund

appears less restrictive than the current standard, but it may be more restrictive than what many governments are currently following in reporting resources in special revenue funds. Some special revenue funds may not meet the additional guidance requiring that a substantial portion of the future inflow come from a restricted or committed resource (see sidebar, "Audit Impact").

Governments will want to determine if their special revenue funds meet the revised definition well ahead of their planned implementation of Statement no. 54. Some of the resources reported in special revenue funds may need to be reported in the general fund. Because the budget cycle for the general fund occurs several months before the beginning of the fiscal year, it is important to know where certain resources will be reported at the start of the budget process. For example, many June 30 fiscal year-end governments will begin work on their fiscal year 2011 (Statement no. 54 implementation year) budget this fall. ♦

## AICPA RESOURCES

### Publications

- *State and Local Governments: Audit and Accounting Guide* (#012669)
- *State and Local Governments: Checklists and Illustrative Financial Statements* (#0090309)
- *State and Local Governmental Developments: Audit Risk Alert* (#0224309)

For more information or to place an order, go to [cpa2biz.com](http://cpa2biz.com) or call the Institute at 888-777-7077.

**Governmental Audit Quality Center**  
The Government Audit Quality Center (GAQC) is a firm membership center that helps member firms achieve the highest standards in Yellow Book, not-for-profit, HUD or government audits through targeted e-mail alerts, resources and teleconferences. Visit the GAQC at [aicpa.org/GAQC](http://aicpa.org/GAQC). For members, the Center has an archived conference call presented by GASB staff and titled "New GASB Fund Balance Standard: Now is the Time to Begin Talking to Your Clients," available at [tinyurl.com/t2ybv5](http://tinyurl.com/t2ybv5).



**FUND BALANCE**

**NEW AND IMPROVED**

**BY STEPHEN J. GAUTHIER**

There is probably no single item in a typical state or local government's financial statements that attracts more attention than fund balance. In February 2009, the Governmental Accounting Standards Board (GASB) issued GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*. This latest GASB standard will not affect the calculation of fund balance, but will fundamentally alter the various components used to report it.

## BACKGROUND

Accountants use the term *fund balance* to describe the arithmetic difference between the assets and liabilities reported in a governmental fund (e.g., general fund). The categories that have been used until now to present fund balance have focused on whether resources were *available for appropriation* (i.e., budgeting). Thus, the traditional presentation of fund balance distinguished *unreserved fund balance* (i.e., available for appropriation) from *reserved fund balance* (i.e., not available for appropriation).

Fund balance might not be available for appropriation (i.e., reserved) for a variety of reasons. Some resources of a governmental fund, by their very nature, cannot be spent (e.g., prepaid rent and inventories of supplies). Other resources may convert to spendable form only at a much later date (e.g., the long-term portion of notes receivable). Still other resources may be available for spending, but their use is externally restricted to a purpose narrower than the purpose of the fund in which they are reported.

In addition, governing bodies themselves frequently place their own limitations on how they will use resources otherwise available for appropriation (e.g., "earmarking"). Likewise, a government's management may have tentative plans for all or a portion of those resources. In either case, a government traditionally has had the *option* of indicating these tentative managerial plans and self-imposed limitations by presenting a portion of unreserved fund balance as *designated*.

This traditional approach to classifying fund balance is summarized in Exhibit 1.

Three considerations led the GASB to undertake its recent reexamination of the components used to report fund balance. First, the traditional terminology was not self-explanatory

and has frequently led to misunderstandings. Second, governments often have applied the different categories inconsistently in practice. Finally, some have questioned whether the historic focus on availability for appropriation best serves the needs of financial statement users.

## NEW GUIDANCE

**Focus.** GASB Statement No. 54 will shift the focus of fund balance reporting from the availability of fund resources for budgeting to "the extent to which the government is bound to honor constraints on the specific purposes for which amounts in the fund can be spent."<sup>1</sup>

**Components of fund balance.** GASB Statement No. 54 establishes five components of fund balance. Because circumstances differ among governments, not every government or every governmental fund will report all of those components.

Constraints on how amounts can be spent are not really an issue for resources that are *inherently nonspendable*. Examples include inventories and prepaids; the long-term portion of loans receivable; and non-financial assets held for resale.<sup>2</sup> Still other resources cannot be spent because *legal or contractual provisions require that they be maintained intact* (e.g., the principal of an endowment). GASB Statement No. 54

directs that the portion of fund balance reflecting both be labeled *nonspendable fund balance*.

Not all limitations on how resources may be used have the same force. Some limitations are externally enforceable and lie beyond the power of the government to change unilaterally (e.g., restrictions imposed by a grant contract or a bond covenant). Other limitations are self-imposed, but would require formal action at the highest level of the government to remove (e.g., resources legally "earmarked" for a given project by the governing body). Still other limitations are less binding and function more as a declaration of intent. GASB Statement No. 54 has created a separate category to accommodate each of these situations.

■ **Restricted fund balance.** The term *restricted fund balance* will encompass net fund resources subject to externally enforceable legal restrictions. It is no accident that the term *restricted fund balance* so closely resembles the term

There is probably no single item in a typical state or local government's financial statements that attracts more attention than fund balance.



## Exhibit 1: Traditional Components of Fund Balance

(Focus on Availability for Appropriation)

### ■ Reserved fund balance (not available for appropriation)

- Portion of net resources that *cannot ever be spent* because of their form
- Portion of net resources that *cannot yet be spent*
- Portion of net resources that *cannot be spent for any and all fund-related purposes* because of external limitations

### ■ Unreserved fund balance (available for appropriation)

- Designated unreserved fund balance (available for appropriation, with a limitation on use imposed by the government itself)
  - Portion of net resources subject to limitations imposed by the governing body
  - Portion of net resources set aside by management in connection with its tentative plans
- Undesignated unreserved fund balance (available for appropriation, with no external or internal limitation)

*restricted net assets* used in the context of government-wide financial reporting. In both cases, the *restrictions* concerned would be either 1) externally imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments, or 2) imposed by law through constitutional provisions or enabling legislation.<sup>4</sup> Note that there is no need for the limitation to be narrower than the purpose of the fund.<sup>5</sup>

■ **Committed fund balance.** The term *committed fund balance* will be used to describe the portion of fund balance that represents resources whose use is constrained by limitations that the government imposes upon itself at its highest level of decision making (normally the governing body) and that remain binding unless removed in the same manner. The underlying action that imposed the limitation would need to occur no later than the close of the reporting period. Note, once again, that there is no requirement that the limitation be narrower than the purpose of the fund.<sup>6</sup>

■ **Assigned fund balance.** The *assigned fund balance* category will cover the portion of fund balance that reflects a government's *intended* use of resources. Such intent would have to be established at either the highest level of decision making, or by a body (e.g., finance committee) or an official designated for that purpose.<sup>7</sup> Logically speaking, a government cannot *assign* resources that it does not have; therefore, the amount reported as *assigned fund balance* could never exceed total fund balance less its nonspendable, restricted, and committed components. Once again, note that there is no requirement that the limitation be narrower than the purpose of the fund.

Of course, the general fund, as the principal operating fund of a government, may have net resources in excess of what is properly categorized in one of the four categories just already described. If so, the surplus will be presented as *unassigned fund balance*. A positive amount of unassigned fund balance, however, will never be reported in a governmental fund other than the general fund, because GASB Statement No. 54 prohibits reporting resources in another fund unless they are at least *assigned* to the purpose of that fund. All the same, funds other than the general fund could report a negative amount of unassigned fund balance should the total of nonspendable fund balance, restricted fund balance, and committed fund balance exceed the total net resources of the fund.

The new components of fund balance are summarized in Exhibit 2.

**Stabilization arrangements.** Governments often establish "rainy day funds" or "contingency funds" to provide a financial cushion against unanticipated adverse financial or economic circumstances. The appropriate classification of such resources within fund balance depends on the specific nature of the arrangement.

On the one hand, if the use of the resources is limited in a way that is legally enforceable by an outside party, classification as restricted fund balance would be appropriate. On the other hand, if the limitation was imposed by the highest level of decision making and can only be removed by formal action equivalent to the action taken to impose it, the use of the committed fund balance classification would be appropriate. It would never be appropriate, however, to classify such resources as assigned fund balance.

## Exhibit 2: New Components of Fund Balance — GASB Statement No. 54

(Focus on Extent to which Government Is Bound to Honor Constraints on the Specific Purposes for Which Amounts Can Be Spent)

- **Nonspendable fund balance** (inherently nonspendable)
  - Portion of net resources that cannot be spent because of their form
  - Portion of net resources that cannot be spent because they must be maintained intact
- **Restricted fund balance** (externally enforceable limitations on use)
  - Limitations imposed by creditors, grantors, contributors, or laws and regulations of other governments
  - Limitations imposed by law through constitutional provisions or enabling legislation
- **Committed fund balance** (self-imposed limitations set in place prior to the end of the period)
  - Limitation imposed at highest level of decision making that requires formal action at the same level to remove
- **Assigned fund balance** (limitation resulting from intended use)
  - Intended use established by highest level of decision making
  - Intended use established by body designated for that purpose
  - Intended use established by official designated for that purpose
- **Unassigned fund balance** (residual net resources)
  - Total fund balance in the general fund in excess of nonspendable, restricted, committed, and assigned fund balance (i.e., surplus)
  - Excess of nonspendable, restricted, and committed fund balance over total fund balance (i.e., deficit)

GASB Statement No. 54, paragraph 20, places serious limits on what qualifies as a *stabilization arrangement* for this purpose:

The formal action that imposes the parameters for spending should identify and describe the specific circumstances under which a need for stabilization arises. Those circumstances should be such that they would not be expected to occur routinely. For example, a stabilization amount that can be accessed “in an emergency” would not qualify to be classified within the committed category because the circumstances or conditions that constitute an emergency are not sufficiently detailed, and it is not unlikely that an “emergency” of some nature would routinely occur. Similarly, a stabilization amount that can be accessed to offset an “anticipated revenue shortfall” would not qualify unless the shortfall was quantified and was of a magnitude that would distinguish it from other revenue shortfalls that occur during the normal course of governmental operations.

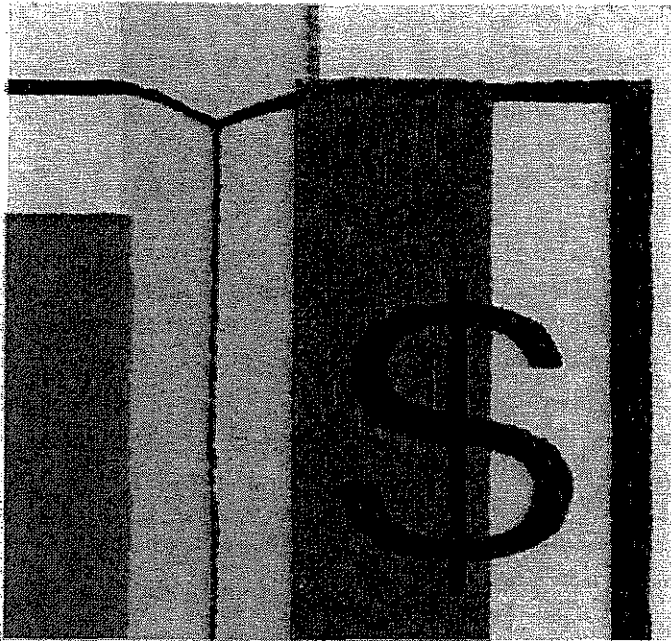
**Appropriated fund balance.** Not infrequently, governments balance their budget by appropriating a portion of existing fund balance to bridge the gap between appropriations and estimated revenues. The portion of fund balance thus appropriated for the following year would properly be classified as assigned fund balance.

**Flow assumptions.** Frequently resources for a single project will come from multiple sources. For example, a city may elect to finance a new bridge partially from restricted grant proceeds (*restricted fund balance*), partially from earmarked revenues (*committed fund balance*), and partially from other available resources expressly set aside for the purpose (*assigned fund balance*). In that case, flow assumptions would be needed:

- When both restricted resources and other resources are to be used, how are outlays allocated to each (e.g., restricted resources presumed to be spent first? Spending presumed to occur on a pro rata basis?)
- When committed, assigned, and unassigned resources are to be used, how are outlays allocated among the various categories?

### COMPARISON OF OLD AND NEW

Perhaps the best way to gain an understanding of the new fund balance categories is to contrast how certain specific items are reported today with how those same items will be reported in the future under GASB Statement No. 54.



**Reserved fund balance.** Currently, reserved fund balance comprises three elements:

- Resources that by their very nature cannot be spent (e.g., prepaid rent)
- Resources that are not yet available for spending (e.g., long-term portion of loans receivable)
- Resources externally restricted to a purpose narrower than the fund

The first of these elements will *always* be reported as nonspendable fund balance. The second element *normally* would be reported as nonspendable fund balance (i.e., unless there was a limitation on how the amounts eventually received could be used, in which case the classification would be restricted, committed, or assigned fund balance, as appropriate). The third element will be reported as restricted fund balance.

**Designated unreserved fund balance.** Currently this category comprises two elements:

- Limitations that the government places upon itself
- Tentative management plans

Net resources currently reflected in the first category will be reported in the future as either committed fund balance or as assigned fund balance, depending upon the source of the limitation. The latter will be reported as either assigned fund balance (if management is designated to make such assignments) or unassigned fund balance.

**Undesignated unreserved fund balance.** Today this residual category includes resources whose use is limited, but not for a purpose narrower than the purpose of the fund. Under GASB Statement No. 54, there is no requirement that a limitation be narrower than the purpose of the fund. Accordingly, items that are restricted, committed, or assigned simply for the purpose of the fund will be reported as restricted, committed, or assigned fund balance.

Also, reporting designated unreserved fund balance today is optional. Under GASB Statement No. 54, the use of the equivalent category (i.e., assigned fund balance) will be required. Therefore, many governments that today do not report designated unreserved fund balance will report as assigned fund balance a portion of what today is labeled simply unreserved fund balance.

#### EFFECTIVE DATE

Governments will need to implement GASB Statement No. 54 starting with the fiscal period that ends June 30, 2011. In the statistical section of the comprehensive annual financial report, retroactive implementation is encouraged, but not required. If a government declines to restate amounts from previous years in the statistical section, it will need to provide an explanation.

#### Notes

1. GASB Statement No. 54, paragraph 5.
2. Assuming that there are not constraints on the use of the amounts eventually collected.
3. Assuming that there are not constraints on the use of the proceeds of the eventual sale.
4. The criteria for restricted net assets set forth in GASB Statement No. 34, *Basic Financial Statements — and Management's Discussion and Analysis — for State and Local Governments*, paragraph 34, are identical to the criteria for *restricted fund balance* in GASB Statement No. 54, paragraph 8.
5. If the use of the amounts to be collected on long-term loans receivable and the amounts resulting from the sale of nonfinancial assets is subject to restrictions, then those items should be reflected in restricted fund balance, rather than in nonspendable fund balance.
6. If the use of the amounts to be collected on long-term loans receivable and the amounts resulting from the sale of nonfinancial assets is committed, then those items should be reflected in committed fund balance, rather than in nonspendable fund balance.
7. If the use of the amounts to be collected on long-term loans receivable and the amounts resulting from the sale of nonfinancial assets is assigned, then those items should be reflected in assigned fund balance, rather than in nonspendable fund balance.

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